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PLR-148033-05

Date:

June 21, 2006

Legend:

Company =

Date 1 =

Date 2 =

Dear :

This letter responds to your September 14, 2005 request for rulings on behalf of Company regarding certain federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated January 3, 2006, January 25, 2006, and April 4, 2006. The information submitted is summarized below.

Company owns, leases, and manages residential and commercial real estate. Company reported its taxable income as a C corporation for all taxable years ending on or before Date 1. Company elected to be taxed as an S corporation within the meaning of § 1361 of the Code effective for tax years beginning on Date 2. Company holds three separate parcels of real property (the "Real Estate") and represents that the Real Estate does not constitute "substantially all" of its assets. Company purchased the Real Estate prior to Date 2 and will recognize gain under § 1374 if it sells the Real Estate within ten years of Date 2 (the "Recognition Period").

Company intends to form a charitable remainder unitrust under § 664 (the "Trust"). Following the formation of the Trust, Company will contribute the Real Estate to the Trust. Subsequently, but before the end of the Recognition Period, the Trust will sell the Real Estate ("Sale Date") and use the sale proceeds to invest in stocks, bonds, and other securities that pay interest and dividends. For a period of 20 years, the Trust will be required to annually distribute a unitrust amount to the Company. At the end of 20 years, the Trust will terminate and all assets remaining in the Trust will be distributed to one or more charities described in §§ 170(c), 2055(a), and 2522(a).

The Trust will be structured initially as a net income with makeup charitable remainder unitrust ("NIMCRUT") and, on the Sale Date, will convert to a fixed percentage charitable remainder unitrust ("CRUT"), as permitted under § 1.664-3(a)(1)(i)(c). As a NIMCRUT, the Trust will annually distribute to Company a unitrust amount equal to the lesser of (1) the Trust's income (as defined under § 643(b) and the applicable regulations) for the year (the "Trust Income") or (2) the fair market value of the Trust's assets multiplied by a fixed payout percentage ("Fixed Percentage Amount"). The unitrust amount for any year will also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (2), to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed under (2) in prior years. After the Trust converts to a CRUT, the Trust will annually distribute to Company a unitrust amount equal to the Fixed Percentage Amount.

Company requests the following rulings:

1. Company will not have recognized built-in gain under § 1374 on its contribution of the Real Estate to the Trust.
2. Company will not have recognized built-in gain under § 1374 on the Trust's disposition of the Real Estate.
3. Company will not have recognized built-in gain under § 1374 on unitrust amounts received by it during the Recognition Period, to the extent the unitrust amounts do not exceed Trust Income.
4. Company will not have recognized built-in gain under § 1374 on unitrust amounts received by it after the Recognition Period.

Section 664(b) provides guidance on how payments from a CRUT are characterized in the hands of the recipient. Under § 664(b), amounts distributed by a CRUT are considered as having the following characteristics in the hands of the unitrust recipient: (1) as ordinary income to the extent of the trust's ordinary income for the trust's taxable year and its undistributed ordinary income for prior years, (2) as capital gain to the extent of the trust's capital gain for the trust's taxable year and its undistributed capital gain for prior years, (3) as other income to the extent of the trust's

other income for the trust's taxable year and its undistributed other income for prior years, and (4) as a distribution of trust corpus.

Section 1374 imposes a corporate-level tax on an S corporation's net recognized built-in gain during the recognition period (generally 10 years) following (a) a C corporation's conversion to S corporation status, or (b) an S corporation's acquisition of C corporation assets in a carryover basis transaction (§ 1374(d)(8)).

Section 1374(d)(2) provides that an S corporation's net recognized built-in gain for any taxable year is generally its taxable income for the year computed as if it were a C corporation, but taking into account only items treated as recognized built-in gain or recognized built-in loss.

Section 1374(d)(3) provides that recognized built-in gain includes any gain recognized on the disposition of an asset during the recognition period, except to the extent the S corporation shows that (a) it did not hold the asset as of the beginning of the first taxable year for which it was an S corporation (the "Conversion Date"), or (b) the gain recognized was greater than the excess of the asset's fair market value over its adjusted basis on the Conversion Date.

Section 1.1374-4(a) of the Federal Income Tax Regulations provides that § 1374(d)(3) applies to any gain or loss recognized during the recognition period in a transaction treated as a sale or exchange for federal tax purposes.

Based solely on the information submitted and the representations made in this ruling request, we rule that:

1. Company will not have recognized built-in gain under § 1374 on its contribution of the Real Estate to the Trust.
2. Company will not have recognized built-in gain under § 1374 on the Trust's disposition of the Real Estate.
3. Company will not have recognized built-in gain under § 1374 on unitrust amounts received by it during the Recognition Period, to the extent the unitrust amounts do not exceed Trust Income. However, Company will have recognized built-in gain under § 1374 to the extent the unitrust amounts received by Company during the Recognition Period are characterized as capital gain under § 664(b) because of the Trust's disposition of the Real Estate.

Except as specifically ruled upon above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, we express no opinion as to whether Company will have recognized built-in gain under § 1374 on unitrust amounts received by it after the Recognition Period. Further, we express no opinion as to whether Trust is a valid

charitable remainder trust and whether the sale of the § 1374 property will create unrelated business taxable income within the meaning of § 512. See § 664(c).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter should be attached to the Federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Mark S. Jennings
Branch Chief, Branch 1
Office of Chief Counsel
(Corporate)

cc: